

FINANCIAL AUDIT
OF THE
MICHIGAN STRATEGIC FUND

October 1, 1998 through September 30, 1999

EXECUTIVE DIGEST

MICHIGAN STRATEGIC FUND

INTRODUCTION	This report contains the results of our financial audit* of the Michigan Strategic Fund (MSF) for the period October 1, 1998 through September 30, 1999.
AUDIT PURPOSE	This financial audit of MSF was conducted as part of the constitutional responsibility of the Office of the Auditor General. Financial audits are conducted at various intervals to permit the Auditor General to express an opinion on the State's financial statements.
BACKGROUND	MSF was created by Act 270, P.A. 1984 (Sections 125.2001 - 125.2093 of the <i>Michigan Compiled Laws</i>), to help diversify the economy of the State and to provide for economic development, primarily by assisting business enterprises in obtaining additional sources of financing. Under the provisions of this Act, MSF succeeded to the rights, properties, obligations, and duties of the Michigan Job Development Authority and the Michigan Economic Development Authority. During our audit period, Executive Order 1999-1, effective April 5, 1999, transferred MSF to the Department of Management and Budget as an autonomous agency, created the Department of Career Development, and abolished the Michigan Jobs Commission.

* See glossary at end of report for definition.

MSF is governed by a nine-member board of directors that consists of the director of the Department of Management and Budget, the State Treasurer, and seven members appointed by the Governor with the advice and consent of the Senate. The MSF Board of Directors is authorized to make grants, loans, and investments of MSF funds to assist both profit and nonprofit businesses.

As of September 30, 1999, all MSF employees (228.5 full-time equated and 13 part-time employees) were detailed* to the Michigan Economic Development Corporation.

AUDIT OBJECTIVES
AND CONCLUSIONS

Audit Objective: To assess and report on MSF's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the financial statements, and on its internal control* over financial reporting, based on our audit of the financial statements.

Conclusion: Our assessment of compliance did not disclose any instances of noncompliance that could have a material effect on MSF's financial statements. Also, our assessment of internal control over financial reporting did not disclose any material weaknesses*. However, our assessment disclosed a reportable condition* regarding MSF accounting and financial reporting (Finding 1).

Audit Objective: To audit MSF's financial statements as of and for the fiscal year ended September 30, 1999.

Conclusion: We expressed an unqualified opinion* on MSF's financial statements.

* See glossary at end of report for definition.

AUDIT SCOPE

Our audit scope was to examine the financial and other records of the Michigan Strategic Fund for the period October 1, 1998 through September 30, 1999. Our audit was conducted in accordance with generally accepted auditing standards and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

AGENCY RESPONSES

Our audit report includes one finding and recommendation. MSF's preliminary response indicates that it agrees with the finding and recommendation.

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Mr. Doug Rothwell, President
Michigan Strategic Fund
201 North Washington Square
Victor Center, 4th Floor
Lansing, Michigan

Dear Mr. Rothwell:

This is our report on the financial audit of the Michigan Strategic Fund for the period October 1, 1998 through September 30, 1999.

This report contains our executive digest; description of agency; audit objectives, audit scope, and agency responses; comments, finding, recommendation and agency preliminary response; and independent auditor's reports on compliance and on internal control over financial reporting and on the financial statements. This report also contains the Michigan Strategic Fund financial statements and notes to the financial statements and a glossary of acronyms and terms.

The agency preliminary response was taken from the agency's response subsequent to our audit fieldwork.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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Description of Agency

The Michigan Strategic Fund (MSF) was created by Act 270, P.A. 1984 (Sections 125.2001 - 125.2093 of the *Michigan Compiled Laws*), to help diversify the economy of the State and to provide for economic development, primarily by assisting business enterprises in obtaining additional sources of financing. Under the provisions of this Act, MSF succeeded to the rights, properties, obligations, and duties of the Michigan Job Development Authority and the Michigan Economic Development Authority. During our audit period, Executive Order 1999-1, effective April 5, 1999, transferred MSF to the Department of Management and Budget as an autonomous agency, created the Department of Career Development, and abolished the Michigan Jobs Commission.

MSF is governed by a nine-member board of directors that consists of the director of the Department of Management and Budget, the State Treasurer, and seven members appointed by the Governor with the advice and consent of the Senate. The MSF Board of Directors is authorized to make grants, loans, and investments of MSF funds to assist both profit and nonprofit businesses.

As of September 30, 1999, all MSF employees (228.5 full-time equated and 13 part-time employees) were detailed to the Michigan Economic Development Corporation.

Audit Objectives, Audit Scope, and Agency Responses

Audit Objectives

Our financial audit of the Michigan Strategic Fund (MSF) had the following objectives:

1. To assess and report on MSF's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the financial statements, and on its internal control over financial reporting, based on our audit of the financial statements.
2. To audit MSF's financial statements as of and for the fiscal year ended September 30, 1999.

Audit Scope

Our audit scope was to examine the financial and other records of the Michigan Strategic Fund for the period October 1, 1998 through September 30, 1999. Our audit was conducted in accordance with generally accepted auditing standards and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Agency Responses

Our audit report includes one finding and recommendation. MSF's preliminary response indicates that it agrees with the finding and recommendation.

The agency preliminary response which follows the recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork.

COMMENTS, FINDING, RECOMMENDATION, AND AGENCY PRELIMINARY RESPONSE

COMPLIANCE AND INTERNAL CONTROL OVER FINANCIAL REPORTING

COMMENT

Audit Objective: To assess and report on the Michigan Strategic Fund's (MSF's) compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the financial statements, and on its internal control over financial reporting, based on our audit of the financial statements.

Conclusion: Our assessment of compliance did not disclose any instances of noncompliance that could have a material effect on MSF's financial statements. Also, our assessment of internal control over financial reporting did not disclose any material weaknesses. However, our assessment disclosed a reportable condition regarding MSF accounting and financial reporting.

FINDING

1. MSF Accounting and Financial Reporting

MSF, in conjunction with the Department of Management and Budget (DMB), did not record certain financial transactions properly and in a timely manner. This contributed to inefficiencies and errors that required adjustments.

Section 18.1492 of the *Michigan Compiled Laws* requires each entity that falls within the reporting responsibility of the State to submit financial statements for inclusion in the *State of Michigan Comprehensive Annual Financial Report* not later than 90 days following the close of the State's fiscal year (by December 31). Also, Section 18.1494 of the *Michigan Compiled Laws* requires that the statements be prepared in accordance with generally accepted accounting principles.

Executive Order 1999-1 transferred various programs of the Michigan Jobs Commission from the General Fund to MSF effective April 5, 1999. This Order also

authorized MSF to enter into an interlocal agreement with one or more local public agencies. MSF entered into such an agreement with the Wayne County Economic Development Corporation to form the Michigan Economic Development Corporation (MEDC). MSF then transferred all but one of the General Fund programs and most of its net assets to MEDC. In addition, the Order provided for DMB to record the financial transactions of MSF and MEDC in the State's financial management system in the most efficient manner possible for the remainder of the fiscal year.

DMB and MSF originally decided not to separate the accounting until the beginning of the new fiscal year. MSF and MEDC continued to process accounting transactions for the programs previously administered by the Michigan Jobs Commission in the State's General Fund through the end of the fiscal year, even though the responsibilities for the programs had transferred six months earlier. In December 1999, DMB, MSF, and MEDC made the decision to record the transfer of the Michigan Jobs Commission programs' costs and unspent authorization from the General Fund to MSF and to include MEDC as a component unit in the *State of Michigan Comprehensive Annual Financial Report* in accordance with generally accepted accounting principles. During the first week of January 2000, DMB approved the processing of entries necessary to record the transfers between the General Fund, MSF, and MEDC.

Because of the delays in determining the proper accounting and reporting treatment related to the Executive Order, MSF and DMB did not have sufficient time to review and verify the propriety of the related accounting transactions needed to properly report the reorganizations and transfers. We noted several errors and additional adjustments relating to transfers, receivables, payables, revenues, and expenditures, which were subsequently corrected. These adjusting entries and delays resulted in MSF and MEDC not providing DMB with draft financial statements by December 31, in accordance with Section 18.1492 of the *Michigan Compiled Laws*. DMB received the financial statement drafts the first week of February 2000.

RECOMMENDATION

We recommend that MSF, in conjunction with DMB, record financial transactions properly and in a timely manner.

AGENCY PRELIMINARY RESPONSE

MSF informed us that it has resolved the issues noted in the finding and that it will take steps to prevent a recurrence.

FINANCIAL ACCOUNTING AND REPORTING

COMMENT

Audit Objective: To audit MSF's financial statements as of and for the fiscal year ended September 30, 1999.

Conclusion: We expressed an unqualified opinion on MSF's financial statements.

Independent Auditor's Report on Compliance and
on Internal Control Over Financial Reporting

February 18, 2000

Mr. Doug Rothwell, President
Michigan Strategic Fund
201 North Washington Square
Victor Center, 4th Floor
Lansing, Michigan

Dear Mr. Rothwell:

We have audited the financial statements of the Michigan Strategic Fund as of and for the fiscal year ended September 30, 1999 and have issued our report thereon dated February 18, 2000. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan Strategic Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to

our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Fund's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in Finding 1.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered to be material weaknesses. However, we believe that the reportable condition described in the previous paragraph is not a material weakness.

This report is intended solely for the information and use of the Michigan Strategic Fund's management and the Legislature and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

Independent Auditor's Report on
the Financial Statements

February 18, 2000

Mr. Doug Rothwell, President
Michigan Strategic Fund
201 N. Washington Square
Victor Center, 4th Floor
Lansing, Michigan

Dear Mr. Rothwell:

We have audited the accompanying balance sheet of the Michigan Strategic Fund as of September 30, 1999 and the related statement of revenues, expenditures, and changes in fund balance for the fiscal year then ended. These financial statements are the responsibility of the Michigan Strategic Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1b, the accompanying financial statements present only the Michigan Strategic Fund and are not intended to present fairly the financial position and results of operations of the State of Michigan, its component unit governmental funds, or the Michigan Economic Development Corporation.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Strategic Fund as of

September 30, 1999 and the results of its operations for the fiscal year then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 18, 2000 on our consideration of the Michigan Strategic Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

MICHIGAN STRATEGIC FUND

Balance Sheet

September 30, 1999

ASSETS

Current Assets:

Cash	\$ 4,563,494
Amounts due from primary government (State of Michigan)	70,052,577
Amounts due from federal government	10,908,716
Amounts due from local government	358,474
Other current assets	<u>7,784,496</u>
Total Current Assets	\$93,667,757

Amounts due from local government	<u>3,542,580</u>
Total Assets	<u><u>\$97,210,336</u></u>

LIABILITIES AND FUND BALANCE

Current Liabilities:

Accounts payable and other liabilities	\$ 9,535,696
Amounts due to component unit (MEDC)	<u>79,357,096</u>
Total Current Liabilities	<u>\$88,892,792</u>

Total Liabilities	<u>\$88,892,792</u>
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Fund Balance

Unreserved fund balance	<u>\$ 8,317,545</u>
Total Fund Balance	<u>\$ 8,317,545</u>

Total Liabilities and Fund Balance	<u><u>\$97,210,336</u></u>
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The accompanying notes are an integral part of the financial statements.

MICHIGAN STRATEGIC FUND
Statement of Revenues, Expenditures, and Changes in Fund Balance
For the Fiscal Year Ended September 30, 1999

REVENUES

Investment income	\$ 3,923,553
Interest on Capital Access Program reserves	141,808
Loan and other interest	725,681
IDRB Program fees	941,518
Technology Center Grant (federal)	1,345,886
Community Development Block Grant (federal)	32,209,473
Tribal gaming	28,520,656
Miscellaneous	<u>3,276,025</u>
Total Revenues	<u>\$ 71,084,603</u>

EXPENDITURES

Administrative	\$ 652,456
BIDCO principal credits	2,084,939
Capital Access Program Disbursements	1,086,431
Technology Center Grant (federal)	1,345,886
Program grants	14,210,740
Community Development Block Grant (federal)	32,121,491
Loan losses	2,159,918
Miscellaneous	<u>87,983</u>
Total Expenditures	<u>\$ 53,749,844</u>

Excess of Revenues Over Expenditures	<u>\$ 17,334,759</u>
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OTHER FINANCING SOURCES (USES)

Operating transfers to MEDC	\$ (126,814,305)
Operating transfers from State of Michigan	<u>101,050,119</u>
Total Other Financing Sources (Uses)	<u>\$ (25,764,187)</u>

Excess of Revenues and Other Sources Over (Under) Expenditures and Other (Uses)	<u>\$ (8,429,428)</u>
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Fund Balance - Beginning	171,380,985
Equity transfer to MEDC	(162,713,480)
Equity transfer from Urban Land Assembly Loan Trust Fund	<u>8,079,468</u>
Fund Balance - Ending	<u>\$ 8,317,545</u>

Some of the revenues and expenditures are reported for part of the year (see Note 1e).

The accompanying notes are an integral part of the financial statements.

Notes to the Financial Statements

Note 1 Significant Accounting Policies

The accounting policies of the Michigan Strategic Fund (MSF) conform to generally accepted accounting principles as applicable to governmental units. The following is a summary of the more significant policies:

a. Reporting Entity

MSF was created by Act 270, P.A. 1984, to help diversify the economy of the State and to provide for economic development, primarily by assisting business enterprises in obtaining additional sources of financing. Under the provisions of this Act, MSF succeeded to the rights, properties, obligations, and duties of the Michigan Job Development Authority and the Michigan Economic Development Authority.

MSF is governed by a nine-member board of directors that consists of the director of the Department of Management and Budget (DMB), the State Treasurer, and seven members appointed by the Governor with the advice and consent of the Senate.

Executive Order 1999-1, effective April 5, 1999, transferred MSF to DMB as an autonomous agency. The Order also transferred the following programs and functions of the Michigan Jobs Commission to MSF:

- Capital Resources Group
- Commercial Redevelopment Act
- Community Development Block Grants
- Department of Economic Expansion and the Economic Expansion Council
- Economic Development Corporations Act
- Economic Development Job Training
- K.I. Sawyer Conversion Authority
- Michigan Business Incubation Act
- Michigan Economic Growth Authority
- Michigan Enterprise Zone Authority
- Michigan International Trade Authority

Michigan Renaissance Zone Act
Michigan Training Incentive Fund
Michigan Travel Commission
Michigan Urban Land Assembly Act
Minority, Women and Small Business Services Units
Neighborhood Enterprise Zones
Office of Business and Education Coordination
Office of Film and Television Services
Office of the Michigan Business Ombudsman
Office of the Small Business Clean Air Ombudsman
Personal Property Tax Exemption
Plant Rehabilitation and Industrial Development Districts
State Education Tax Exclusion
Travel Michigan
Wurtsmith Conversion Authority

Executive Order 1999-1 further provided that MSF would have the authority to enter into an interlocal agreement with local public agencies. Under this authority, MSF created the Michigan Economic Development Corporation (MEDC) as a new public entity to help administer programs transferred to MSF. Any economic development programs transferred to MSF could be transferred, along with the relevant personnel and funding, to the new MEDC. MSF entered into an interlocal agreement with the Economic Development Corporation of the Charter County of Wayne, and MEDC was formed.

MSF is considered to be a component unit of the financial reporting entity of the State of Michigan. The decision to include a potential component unit in the reporting entity is made by applying the criteria set forth in Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*. The basic criteria include the appointment of a voting majority of the governing board of MSF; the legal separation of the State and MSF; the fiscal independence of MSF; whether exclusion of the unit would make the *State of Michigan Comprehensive Annual Financial Report* misleading; and whether there is a potential for MSF to provide specific financial benefits to, or impose specific financial burdens on, the State.

b. Basis of Presentation

Under fund accounting, the accounts of the component units of the State of Michigan are organized on the basis of funds, each of which is considered a separate accounting entity. MSF's operations are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, and expenditures. Government resources are allocated to and accounted for in separate funds, based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

MSF is accounted for as a governmental fund. The accompanying financial statements present only MSF and are not intended to present fairly the financial position and results of operations of the State of Michigan, its component unit governmental funds, or MEDC.

c. Measurement Focus/Basis of Accounting

The term "measurement focus" refers to what is being measured, and the term "basis of accounting" refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

Governmental fund types are accounted for using the modified accrual basis of accounting. The modified accrual basis emphasizes the measurement of current financial resources and obligations. Revenues are recorded when they are measurable and available to finance expenditures of the current period. Expenditures are recorded at the time fund liabilities are incurred.

d. Accounting Change

MSF is accounted for as a governmental fund. Prior to fiscal year 1998-99, MSF had been reported as a proprietary component unit. The Urban Land Assembly Loan Trust Fund is also included in the MSF financial statements. Prior to fiscal year 1998-99, this Fund had been reported as an expendable trust fund.

e. Financial Data

The MSF Board of Directors entered into an interlocal agreement with a local public agency to create MEDC. MEDC came into existence on April 5, 1999. In accordance with the terms of the agreement, substantial assets, liabilities, and fund balances of MSF were transferred to MEDC on May 1, 1999. All revenues received from tribal casino gaming, industrial development revenue bond issuance fees, and other sources since May 1, 1999 were transferred to MEDC on a monthly basis. This interlocal agreement also detailed all State classified employees to MEDC. State appropriations available to MSF for this purpose were also made available to MEDC, as needed.

MSF financial statements primarily present the following:

- (1) Revenues: Amounts received from tribal gaming revenue, the interest on Urban Land Assembly Loan Trust Fund, the Community Development Block Grant (CDBG) from the federal Department of Housing and Urban Development, and other revenues, including investment income.
- (2) Expenditures: CDBG pass-through grants for April 1, 1999 through September 30, 1999 and MSF nonappropriated program grant disbursements for the period October 1, 1998 through April 30, 1999. MSF program grant expenditures incurred after April 30, 1999 were obligations of MEDC and are recorded in MEDC. The following table identifies the MSF expenditures through April 30, 1999:

Detroit Downtown Development Authority	\$4,901,051
Governor's Career Scholarship	3,125,031
Center for Virtual Learning	632,775
Research Centers	2,396,461
Center for Michigan's Renaissance	966,209
Renaissance Zones	109,238
MERRA	55,000
Michigan Technologies	21,484
M-TEC	3,492
Michigan Virtual University	2,000,000
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Total	\$14,210,741
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- (3) Other Financing Sources (Uses): Amounts available to MSF from State appropriations for the period April 1, 1999 through September 30, 1999. All related expenditures, encumbrances, and payables are recorded in MEDC as required by generally accepted accounting principles. Also included in other financing uses is the tribal gaming revenue collected by MSF and transferred to MEDC during May 1, 1999 through September 30, 1999.
 - (4) The equity transfer to MEDC represents the net assets transferred to MEDC on May 1, 1999. The equity transfer from Urban Land Assembly Loan Trust Fund represents the transfer of the net assets of the Fund to MSF.
- f. Investments
All investments of MSF, along with liabilities, were transferred to MEDC during the year and reported by MEDC.
 - g. Compensated Absences
The accumulated compensated absences liability is recorded in MEDC.

Note 2 Deposits and Investments

- a. General Information
MSF's policy is to invest in the following investment types:
 - (1) Securities issued or guaranteed by the U.S. government or its agencies.
 - (2) Repurchase agreements fully collateralized by U.S. government securities.
 - (3) Corporate and bank debt including, but not limited to, commercial paper, certificates of deposit, banker's acceptances, and other short-term obligations.
 - (4) Corporate notes and bonds.

(5) Taxable bond funds.

(6) Money market mutual fund shares that offer daily purchase and redemption and maintain a constant share price.

b. Deposits

In accordance with GASB Statement No. 3, deposits are classified into three categories of credit risk as follows:

Category 1: Insured or collateralized with securities held by the entity or by its agent in the entity's name.

Category 2: Collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name.

Category 3: Uncollateralized, including bank balances that are collateralized with securities held by the pledging financial institution or by its trust department or agent, but not in the entity's name.

Deposits reflected in MSF's bank accounts (without recognition of outstanding checks or deposits in transit) were \$205,920 at September 30, 1999. Of that amount, \$100,000 was covered by federal depository insurance and was classified in GASB credit risk category 1. The remaining \$105,920 was uninsured and uncollateralized at September 30, 1999 and was classified in GASB credit risk category 3. A cash deposit of \$4,357,574 was placed with the State Treasurer and held as equity in Common Cash.

c. Investments

All investment assets of MSF were transferred to MEDC on May 1, 1999.

Note 3 Accounts Receivable

MSF accounts receivable amounted to \$92,646,842 at September 30, 1999. This balance consisted of:

Primary Government

Accounts payable	\$ 22,159,571
Accounts receivable	(10,957,583)
Encumbrances	28,400,704
Technical center grants	30,000,000
Miscellaneous	449,884
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Amounts Due From Primary Government (State of Michigan)	\$ 70,052,577

Local Government

Urban Land Assembly Loan Trust Program (current and long-term)	\$ 3,901,053
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Federal Government

CDBG	\$ 10,908,716
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Other Current Assets

Tribal gaming revenue	\$ 7,735,628	
Miscellaneous	48,868	
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Total other current assets		\$ 7,784,496

Amounts due from tribal gaming revenue at September 30, 1999 represent amounts due through June 30, 1999 (see Note 9 for further discussion).

Note 4 Loans Receivable

All loans receivable were transferred to MEDC on May 1, 1999. During the year, MSF recognized a loss of \$2,159,918 for the uncollectible accrued interest on loans.

Note 5 Accounts Payable

MSF accounts payable include amounts due to:

CDBG Subgrantees		\$9,535,696
Component Units - MEDC:		
Accounts payable	\$12,623,878	
Encumbrances	28,400,704	
Technical center grants	30,000,000	
Miscellaneous	449,884	
Total Appropriated Funds	<u>\$71,474,465</u>	
Tribal gaming revenue receivable	<u>7,882,631</u>	
Total Component Units - MEDC		79,357,096
Total MSF Accounts Payable		<u><u>\$88,892,792</u></u>

Note 6 Bond Programs

MSF and a predecessor entity (the Michigan Job Development Authority) issued industrial development revenue bonds (IDRBs). In addition, MSF issued bonds under its Taxable Bond Program. The bonds issued are payable solely from the net revenues of the project and are not an obligation of MSF or the State of Michigan. After the bonds are issued, all financial activities are assumed by a trustee, depository, or paying agent. Accordingly, these obligations are not reported in the MSF financial statements. Information regarding the status of such bond issues, including possible default, must be obtained from the trustee or depository for bonds, the industrial or commercial enterprise benefited by the bonds, or some other knowledgeable source.

The total amount of IDRBs issued by MSF and its predecessor entity for the period January 1, 1979 through September 30, 1999 was \$4,740,501,439. The total amount of bonds issued by MSF under the Taxable Bond Program for the period October 1, 1998 through September 30, 1999 was \$1,300,000.

Note 7 Commitments and Contingencies

All commitments and contingencies of MSF were transferred to MEDC on May 1, 1999 along with the assets.

Note 8 Major Revenue Sources

One of the major revenue sources of MSF is its 8% share of the net revenues derived from the class III electronic games of several casinos operated by seven Native American tribes located throughout Michigan. MSF has received money from this source since March 1994. During the fiscal year ended September 30, 1999, revenue was recognized from this source in the amount of \$28,520,656. This amount represented approximately 40% of total revenues for the fiscal year ended September 30, 1999. MSF also recorded \$32,209,473 in revenue and \$32,121,491 in expenditures during 1999 for the CDBG Program.

An initiative approved by Michigan voters in November 1996 allowing up to three casinos to operate in Detroit has the apparent effect for continued payment by the tribes of these revenues to MSF. Therefore, fiscal year 1998-99 receivables are calculated through June 30, 1999 for all but two casinos. Two casinos stopped remitting required payments after February 19, 1999. This matter is in litigation and MSF has not recorded any revenue or receivables for the amounts that may be recovered, in the event of a favorable outcome, for the period February through June 1999.

New compacts with four additional tribes were approved by a legislative resolution in December 1998. One of these four casinos became operational in July and made a first payment on December 1, 1999. Revenue received from these four casinos will replace revenue lost from the earlier compact with seven tribes, to some extent, and will enable MSF/MEDC to continue to pursue its intended mission of aiding economic development in Michigan.

Note 9 Contingency

Sault Ste. Marie Tribe of Chippewa Tribes, et al. v John M. Engler, Governor of the State of Michigan

In March 2000, a federal circuit judge agreed that the obligation of the seven tribes, which are parties to a consent judgment and the first compacts to make payments to the MSF, ceased in February 1999. This ruling only affects two tribes involved in the lawsuit as the other five tribes have already entered into settlements with the State. The State is appealing the judge's ruling. Neither of the two tribes has made payments for the period beyond February 1999,

nor has MEDC recorded any receivable for the revenue accrued after February 1999.

Note 10 Subsequent Event

Taxpayers of Michigan Against Casinos, et al. v State of Michigan

In January 2000, an Ingham County circuit judge issued a declaratory ruling that the four new compacts were adopted in an unconstitutional manner. The State has appealed that ruling. It is not anticipated that this ruling will have an immediate effect on payments from the tribes because the compacts remain in effect until a federal court rules that they are void. It is not anticipated that federal authorities would or could pursue such a ruling until after State appeals are exhausted.

Glossary of Acronyms and Terms

BIDCO	business and industrial development corporation.
CDBG	Community Development Block Grant.
detailed employees	The temporary assignment of employees from a governmental entity to another business entity. Employees in this capacity continue to receive the same compensation and benefits of the original employer, but receive day-to-day direction (work assignments and supervision) from the entity they are detailed to.
DMB	Department of Management and Budget.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial statements of an audited entity are fairly presented in conformity with generally accepted accounting principles.
GASB	Governmental Accounting Standards Board.
IDRB	industrial development revenue bond.
internal control	A process, effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations.

material weakness	A condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
MEDC	Michigan Economic Development Corporation.
MSF	Michigan Strategic Fund.
M-TEC	Michigan Technical Education Centers.
reportable condition	A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect MSF's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.
unqualified opinion	An auditor's opinion in which the auditor states, without reservation, that the financial statements are fairly presented in conformity with generally accepted accounting principles.